MALAYSIA

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators

(Millions of U.S. Dollars unless otherwise indicated)

	1996	1997	1998	1/
Income, Production and Employment:				
Nominal GDP	99,516	97,995	71,381	2/
Real GDP Growth (pct)	8.6	7.7	-6.0	3/
GDP by Sector (1978 prices):				
Agriculture	6,607	5,980	4,034	
Manufacturing	17,802	17,890	12,081	
Mining And Petroleum	3,737	3,372	2,397	
Construction	2,450	2,396	1,387	
Services	16,691	15,924	10,964	
Government Services	4,753	4,503	3,305	
Per Capita GDP (US$)	4,703	4,552	4,283	
Labor Force (000s)	9,010	9,038	9,007	
Money and Prices (annual percentage growth):				
Money Supply Growth (M2)(pct)	19.8	22.7	5.9	4/
Consumer Inflation (pct)	3.5	2.7	5.2	4/
Exchange Rate (RM/US$ annual average)	2.51	2.81	3.92	
Balance of Payments and Trade:				
Total Exports FOB	76,943	77,829	71,492	
Exports to U.S.	17,025	18,017	13,802	5/
Total Imports FOB	73,307	73,879	60,593	
Imports from U.S. 5/	8,521	10,828	6,901	5/
Trade Balance	3,426	3,950	10,899	
Balance with U.S.	9,304	7,189	6,901	
External Public Debt	15,820	23,280	17,468	6/
Fiscal Surplus/GDP (pct)	0.7	2.4	-3.4	
Current Account Deficit/GDP (pct)	5.2	4.9	7.2	7/
Debt Service Payments/GDP (pct)	4.9	5.0	N/A	
Gold and Foreign Exchange Reserves	27,894	21,040	23,715	8/
Aid from U.S.	0.6	0.6	0.9	

Aid from All Other Countries	N/A	N/A	N/A

1/ Malaysian Government estimates.
2/ Converted at annual average exchange rates.
3/ Calculated in ringgit to avoid exchange rate changes.
4/ October data for 1998.
5/ U.S. Commerce Department data, January-September for 1998.
6/ June data for 1998.
7/ Surplus for 1998.
8/ End-November data for 1998.

1. General Policy Framework

Until mid-1997, Malaysia enjoyed three decades of relatively uninterrupted economic growth and increasing diversification from an early reliance on tin, rubber and palm oil into manufacturing and, more recently, information technology. Sound macroeconomic policies and a favorable international environment contributed to overall prosperity. Since July 1997, however, Malaysia has been buffeted by the regional economic and financial downturn that erupted with the Thai financial crisis. By mid-1998 Malaysia was in recession. Real GDP contracted by 2.8 percent in the first quarter, 6.8 percent in the second quarter, and 8.6 percent in the third quarter, year-on-year. From the outset of the crisis in July 1997 to the end of August 1998, the Kuala Lumpur stock exchange lost 73 percent of its capitalization, while the ringgit (Malaysia's currency) depreciated roughly 67 percent against the U.S. Dollar.

Despite entering the crisis with relatively stronger fundamentals than its neighbors, investor concerns have grown over excessive commercial property investment, high levels of domestic corporate debt, government-funded megaprojects, the lack of transparent policies regarding support for troubled firms, and continued trade and investment restrictions.

To deal with increasing stresses on Malaysia's banking sector, the government established DANAHARTA, also known as the Asset Management Corporation, to purchase or manage nonperforming loans, and DANAMODAL, a special purpose vehicle to inject funds into banks in need of recapitalization. Bankruptcies have risen, and several major Malaysian corporations, burdened with heavy debt loads, have recently sought court protection from creditors. The government has also created a Corporate Debt Restructuring Committee to provide a framework for creditors to resolve liquidity problems of viable businesses and reduce the number of companies seeking bankruptcy protection.

The government plays a strong pro-active economic role. This role includes: investor, economic planner, approver of investment projects, approver of public and private procurement decisions, author and implementor of policies and programs to bolster the economic status of the Malay and indigenous communities (commonly referred to as *bumiputras*), and decisionmaker over privatization contracts. The government holds equity stakes (generally minority shares) in a wide range of domestic companies -- usually large players in key sectors -- and can exert considerable influence over their operations. The current economic downturn, however, has slowed the push to privatization. The government has said it will consider granting assistance to troubled corporations on the basis of three criteria: national interest, strategic interest, and equity considerations under *bumiputra* policies.

Tariffs are the main instrument used to regulate the importation of goods in Malaysia. However, 17 percent of Malaysia's tariff lines (principally in the construction equipment, forestry, logging, agricultural mineral, and motor vehicle sectors) are also subject to non-automatic import licensing designed to protect import-sensitive or strategic industries. Although the average applied MFN tariff rate of Malaysia has declined to approximately 8.1 percent, duties for tariff lines where there is significant local production are often higher. For example, 15.8 percent of product tariff lines in Malaysia's tariff schedule have rates over 24 percent, 25.9 percent of tariff lines have rates over 15 percent, and many lines have rates well over 100 percent.

The level of tariff protection is generally lower on raw materials and increases for those goods with value-added content or which undergo further processing. The government urges Malaysians to purchase domestic products, instead of imports, whenever possible. Malaysia has been an active participant in multilateral and regional trade fora such as the World Trade Organization (WTO) and APEC (which it chaired in 1998).

Fiscal Policy: The government is pursuing an expansive fiscal policy in order to stimulate economic growth. The government expects to run a 1998 budget deficit slightly higher than 3.7 percent of GNP. Malaysia's national economic recovery plan calls for RM 53 billion ($14 billion) in new public spending. The 1999 budget deficit is projected to reach 6.6 percent of GDP. The downgrading of Malaysia's sovereign debt by international rating agencies put on hold plans to raise in international capital markets at least part of the funds the government will require.

Monetary Policy: The central bank has been progressively loosening monetary policy to lead the economy out of recession. Statutory reserve requirements have been reduced steadily from 13.5 percent as of year-end 1997 to 4 percent in September 1998. The central bank also lowered the liquid asset requirements for commercial banks, reduced an administrative margin used to calculate the base lending rate, and cut its 3 month intervention rate from 8 percent to 7 percent. The loosening of monetary policy has been accompanied by a significant drop in interest rates. The base lending rate dropped from 12.27 percent at the end of June to 8.05 percent in early November 1998.

2. Exchange Rate Policy

On September 1, 1998, as part of a broader effort to reflate the economy and stabilize the currency, the government took drastic action by fixing the exchange rate of the ringgit to the U.S. Dollar at RM 3.8/US$1 and instituting selective capital controls. Malaysia's principal objectives in instituting the controls are to eliminate offshore trading in the ringgit and insulate the domestic economy from external risks posed by short term capital flows. The exchange controls reduce the ability of nonresidents to engage in ringgit transactions, require settlement of imports and exports in foreign currencies, discourage short-term capital inflows by requiring them to remain in the country for at least one year, restrict Malaysian investment overseas, and limit the amount of foreign currency individuals and corporations can take out of the country. The government has stressed that the measures maintain general convertibility of current account transactions, and do not impair repatriation of interest, profits, dividends and commissions on investments. The government has also stated that the controls are temporary and will be lifted once the international financial infrastructure addresses destabilizing capital flows which the government blames in large part for recent economic difficulties.

3. Structural Policies

Pricing Policies: Most prices are market-determined but controls are maintained on some key goods, such as vegetable oil, fuel, public utilities, cement, motor vehicles, rice, flour, sugar, tobacco, and chicken. (Note: no restrictions are placed on wheat imports.)

Tax Policies: Tax policy is geared toward raising government revenue and discouraging consumption of "luxury" items. Income taxes, both corporate and individual, comprise 40 percent of government revenue with indirect taxes, export and import duties, excise taxes, sales taxes, service taxes and other taxes accounting for another 31 percent. The remainder comes largely from dividends generated by state-owned enterprises and petroleum taxes. To spur economic recovery, the government declared that corporate and individual income earned in 1999 will not be taxed but losses incurred in 1999 can be carried forward.

A change in the tax assessment system effective in the year 2000 to tax collection based on current year income rather than previous year income, will insure that government tax revenues continue without interruption. The 1999 budget provides tax incentives to encourage exports, business loan refinancing, financial institution mergers, and food production. It raises excise duties, however, on alcohol, cigarettes, and gaming. High-technology and information-technology companies which establish in the multimedia super corridor (a government-established zone designed to concentrate and stimulate development of multimedia industries) and export-oriented foreign investments are allowed attractive tax incentives.

Standards: Malaysia has extensive standards and labeling requirements, but these appear to be largely implemented in an objective, nondiscriminatory fashion. Food product labels must provide ingredients, expiry dates and, if imported, the name of the importer. Electrical equipment must be approved by the Ministry of International Trade and Industry, telecommunications equipment must be "type approved" by the Department of Telecommunications and aviation equipment must be approved by the Department of Civil Aviation. Pharmaceuticals must be registered with the Ministry of Health. In addition, the Standards and Industrial Research Institute of Malaysia provides quality and other standards approvals.

4. Debt Management Policies

Malaysia’s medium and long-term foreign debt (both public and private sector) amounted to $32.5 billion at the end of 1997, about 33 percent of GDP. Malaysia’s debt service ratio declined from a peak of 18.9 percent of gross export earnings in 1986 to 5.1 percent in 1997.

5. Significant Barriers to U.S. Exports

Import Restrictions on Motor Vehicles: Malaysia maintains several measures to protect the local automobile industry, including high tariffs and an import quota and licensing system on imported motor vehicles and motor vehicle parts. Malaysia also maintains local content requirements of 45 to 60 percent for passenger and commercial vehicles, and 60 percent for motorcycles. The government has announced that local content restrictions will be phased out by the year 2000 in accordance with its WTO commitments (see investment barriers). These restrictions have hampered the ability of U.S. firms to penetrate the Malaysian market. Customs tariffs and excise duties (up to 50 percent) for motorcycles are also significant barriers for U.S. companies. Malaysia is also considering new emissions standards for motorcycles which could restrict market opportunities for imports.

Products	*Tariff (pct)*
Automobiles (CB)	140-300
Automobiles (CKD)	80
Vans (CBU)	42-140
Van (CKD)	40
4WD/ Multipurpose (CBU)	60-200
4WD/ Multipurpose (CKD)	40
Motorcycle (CBU)	80-120
Motorcycle (CKD)	30

Restrictions on Construction Equipment: In October 1997, Malaysia imposed a restrictive licensing regime on imports of heavy construction equipment and raised import duties for the second year in a row, as detailed below. In October 1996, it raised duties on construction equipment from 5 to 20 percent. In addition, the initial capital allowance for imported heavy equipment will be reduced from 20 to 10 percent in the first year, and the annual allowance will be reduced from between 12 percent and 20 percent to 10 percent.

Products	*Tariff (pct)*
Heavy Machinery & Equipment	5
Multi-Purpose Vehicles	50
Special Purpose Vehicles	50
Construction Materials	10-30

Duties on High Value Food Products: Duties for processed and high value products, such as canned fruit, snack foods, and many other processed foods, range between 20 and 30 percent. The applied tariff on soy protein concentrate is 20 percent.

Duties on Alcoholic Beverages and Tobacco Products: High tariffs (increased 10/23) on tobacco products ($10.5-48/kg) and alcoholic beverages (e.g., vermouth in retail-sized containers is subject to a specific tariff of $31.5/dal) hamper U.S. exports.

Plastic Resins: U.S. exports of some plastic resins are hampered by 20 percent tariffs.

Tariff-Rate Quota for Chicken Parts: Although the government applies a zero import duty on chicken parts, imports are regulated through licensing and sanitary controls, and import levels remain well below the minimum access commitments established during the Uruguay Round.

Float Glass Tariff Differentials: Malaysia levies high duties (65 sen/kilogram or 50-100 percent ad valorem equivalent) on rectangular-shaped float glass. Nearly all float glass that moves in world trade is rectangular. To qualify for the lower ad valorem MFN tariff rate of 30 percent levied on non-rectangular float glass, exporters often must resort to time-consuming, wasteful procedures such as cutting off one or more corners or cutting one edge in a slanted fashion. This is an inefficient and expensive process which requires distributors to recut each piece of glass into a rectangular shape once it has cleared customs.

Rice Import Policy: The sole authorized importer of rice is a government corporation with the responsibility of ensuring purchase of the domestic crop and wide power to regulate imports.

Film and Paper Product Tariff: Malaysia applies a 25 percent tariff on imported instant print film that is estimated to cause an annual trade loss of $10 to $25 million for U.S. industry. In August 1994, the government raised tariffs on several categories of imported kraft linerboard (used in making corrugated cardboard boxes) to between 20 and 30 percent depending on the category. These tariff increases are to be phased out after five years and are subject to review every two years. Malaysia did not change the tariff levels after the 1996 review.

Direct Marketing Companies: Malaysia implemented a policy in March 1998 requiring direct marketing companies, as a condition for annual license renewal, to source 80 percent or more of their products locally. It began to enforce more rigidly a guideline for foreign participation in wholesale and retail trade requiring 30 percent of the equity in direct marketing companies for *bumiputras* and 70 percent overall domestic ownership. The Ministry of Domestic Trade and Consumer Affairs has indicated that it may grant exceptions to these rules on a case-by-case basis.

Government Procurement: Malaysian Government policy calls for procurement to be used to support national objectives such as encouraging greater participation of ethnic Malays (*bumiputra*) in the economy, transfer of technology to local industries, reducing the outflow of foreign exchange, creating opportunities for local companies in the services sector, and enhancing Malaysia's export capabilities. As a result, foreign companies do not face a level playing field in competing for contracts and in most cases are required to take on a local partner before their bid will be considered. Some U.S. companies have voiced concerns about the transparency of decisions and decision making processes. Malaysia is not a party to the plurilateral WTO Government Procurement Agreement.

Investment Barriers: Malaysia encourages direct foreign investment particularly in export-oriented manufacturing and high-tech industries, but retains considerable discretionary authority over individual investments. Especially in the case of investments aimed at the domestic market, it has used this authority to restrict foreign equity (normally to 30 percent) and to require foreign firms to enter into joint ventures with local partners. To alleviate the current economic downturn, Malaysia announced it will relax -- until 12/31/2000 -- foreign-ownership and export requirements in the manufacturing sector for companies producing goods that do not compete with local producers. Facing a tight labor supply situation, foreign companies have found it hard to operate manufacturing facilities efficiently due to the difficulty associated with obtaining permission from the government to bring in workers from abroad. Most foreign firms also face restrictions in the number of expatriate workers they are allowed to employ.

Trade-Related Investment Measures: Malaysia has notified the WTO of certain measures that are inconsistent with its obligations under the WTO agreement on Trade-Related Investment Measures (TRIMS). The measures deal with local requirements in the automotive sector. New projects or companies granted "pioneer status" are eligible to receive a 70 percent income tax exemption. Proper notification allows developing-county WTO members to maintain such measures for a five-year transitional period after entry into force of the WTO. Malaysia therefore must eliminate these measures before January 1, 2000. The United States is working in the WTO committee on TRIMS to ensure that WTO members meet these obligations.

Services Barriers: Under the WTO basic telecommunications agreement, Malaysia made commitments on most basic telecommunications services and partially adopted the reference paper on regulatory commitments. Malaysia guaranteed market access and national treatment for these services only through acquisition of up to 30 percent of the shares of existing licensed public telecommunications operators, and limits market access commitments to facilities-based providers. At least two U.S. firms have investments in basic and enhanced services sectors.

Professional Services: Foreign professional services providers are generally not allowed to practice in Malaysia. Foreign law firms may not operate in Malaysia except as minority partners with local law firms, and their stake in any partnership is limited to 30 percent. Foreign lawyers may not practice Malaysian law or operate as foreign legal consultants. They cannot affiliate with local firms or use their international firm's name.

Under Malaysia’s registration system for architects and engineers, foreign architects and engineers may only seek temporary registration. Foreign architectural firms are eligible only for special projects as agreed between Malaysia and an interested foreign government. Unlike engineers, Malaysian architectural firms may not have foreign architectural firms as registered partners. Foreign architecture firms may only operate as affiliates of Malaysian companies. Foreign engineering companies must establish joint ventures with Malaysian firms and receive "temporary licensing" which is granted only on a project-by-project basis and is subject to an economic needs test and other criteria imposed by the licensing board. Foreign accounting firms can provide accounting or taxation services in Malaysia only through a locally registered partnership with Malaysian accountants or firms, and aggregate foreign interests are not to exceed 30 percent. Auditing and taxation services must be authenticated by a licensed auditor in Malaysia. Residency is required for registration.

Banking: No new licenses are being granted to either local or foreign banks; foreign banks must operate as locally-controlled subsidiaries. Foreign-controlled companies are required to obtain 60 percent of their local credit from Malaysian banks. Insurance branches of foreign insurance companies were required to be locally incorporated by June 30, 1998; however, the government has reportedly offered extensions of up to one year to that requirement. Foreign share holding exceeding 49 percent is not permitted unless the Malaysian Government approves higher shareholding levels. As part of Malaysia's WTO financial services offer, the government committed to allow existing foreign shareholders of locally incorporated insurance companies to increase their shareholding to 51 percent once the WTO Financial Services Agreement goes into effect in 1999. New entry by foreign insurance companies is limited to equity participation in locally incorporated insurance companies and aggregate foreign shareholding in such companies shall not exceed 30 percent.

Securities: Foreigners may hold up to 49 percent of the equity in a stockbroking firm. Currently there are 11 stockbroking firms which have foreign ownership and 20 representative offices of foreign brokerage firms. Fund management companies may be 100 percent foreign-owned if they provide services only to foreign investors, but they are limited to 70 percent foreign-ownership if they provide services to both foreign and local investors.

Advertising: Foreign film footage is restricted to 20 percent per commercial, and only Malaysian actors may be used. The government has an informal and vague guideline that commercials cannot "promote a foreign lifestyle." Advertising of alcohol products is severely restricted.

Television and Radio Broadcasting: The government maintains broadcast quotas on both radio and television programming. Sixty percent of television programming is required to originate from local production companies owned by ethnic Malays. This share is scheduled to increase to 80 percent by the year 2000. Sixty percent of radio programming must be of local origin. The Ministry of Information announced in January 1998 that it would study the use of the Broadcasting Act of 1988 as the means of imposing further conditions on TV stations to provide additional air time to local programming.

Other Barriers: U.S. companies have indicated that they would welcome improvements in the transparency of government decision-making and procedures, and limits on anti-competitive practices. A considerable proportion of government projects and procurement are awarded without transparent competitive bidding. The government has declared that it is committed to fighting corruption and maintains an anti-corruption agency (a part of the office of the Prime Minister) to promote that objective. The agency has the independent power to conduct investigations and is able to prosecute cases with the approval of the Attorney General.

6. Export Subsidies Policies

Malaysia offers several export allowances. Under the export credit refinancing scheme operated by the central bank, commercial banks and other lenders provide financing to exporters at a preferential interest rate for both post-shipment and pre-shipment credit. Malaysia also provides tax incentives to exporters, including double deduction of expenses for overseas advertising and travel, supply of free samples abroad, promotion of exports, maintaining sales offices overseas, and research on export markets. To spur exports, 70 percent of the increased export earnings by international trading companies has been exempted from taxes.

7. Protection of U.S. Intellectual Property

Malaysia is a member of the World Intellectual Property Organization (WIPO), the Berne Convention, and the Paris Convention. Malaysia provides copyright protection to all works published in Berne Convention member countries regardless of when the works were first published in Malaysia. Malaysia is also a member of the World Trade Organization.

As the number of manufacturing licenses for CDs has increased, so have piracy rates for music and video discs. Malaysia's production capacity for CDs far exceeds the size of the domestic market, and so the excess production is smuggled into other Asian countries. The Malaysian Government is aware of the problem and has expressed its determination to move against illegal operations.

In March 1998, the government opened an intellectual property training center to develop and offer programs for government officials, agencies, attorneys, and the judiciary. Police and legal authorities are generally responsive to requests from U.S. firms for investigation and prosecution of copyright infringement cases. Joint government and industry anti-piracy campaigns and increased enforcement efforts have reduced packaged computer software piracy to 70 percent in 1997, a 10 percent decline from 1996.

The effect of Malaysian enforcement efforts would be enhanced through the resolution of lengthy litigation, seizure of CD replicating equipment from factories caught producing pirated works, as well as the imposition of more substantial fines against infringers. In that regard, the Attorney General directed deputy public prosecutors in March 1998 to file appeals for all cases under the copyright law if courts impose fines of less than RM 1,000 ($263). Suppressing CD-based digital piracy is consistent with the government's objective to establish the multimedia super corridor as the preeminent locus of high-technology manufacturing and innovation in Asia. Notwithstanding these efforts of the government, illegal production of optical disks remains a significant problem in Malaysia, and its effects have been observed throughout the region.

Trademark infringement and patent protection have not been serious problem areas in Malaysia for U.S. companies.

8. Worker Rights

a. The Right of Association: By law most workers have the right to engage in trade union activity, and approximately 10 percent of the work force are members of trade unions. Exceptions are certain categories of workers labeled "confidential" and "managerial and executives," as well as police and defense officials. Government policy places a de facto ban on the formation of national unions in the electronics sector, but allows in-house unions.

b. The Right to Organize and Bargain Collectively: Collective bargaining is the norm in Malaysian industries where workers are organized. However, collective bargaining rights are effectively restricted by compulsory arbitration requirements. In practice, labor actions such as strikes are extremely rare in Malaysia.

c. Prohibition of Forced or Compulsory Labor: There is no evidence that forced or compulsory labor occurs in Malaysia for either Malaysian or foreign workers, except for rare cases which are prosecuted vigorously by the government.

d. Minimum Age for the Employment of Children: No child under the age of 14 may be engaged in any employment except light work in a family enterprise or in public entertainment, work performed for the government in a school or training institution, or employment as an approved apprentice. In addition, regulations prohibit children from working more than 6 hours per day, more than 6 days per week, or at night. However, there have been reports of widespread employment of children below the age of 14 working full-time on plantations.

e. Rights in Sectors with U.S. Investment: Working conditions are generally on a par with industrialized country standards. The Occupational Safety and Health Act covers all economic sectors except the maritime sector and the military. Other laws provide for retirement programs, disability and workman's compensation benefits. No comprehensive national minimum wage legislation exists, but certain classes of workers are covered by minimum wage laws. Plantation and construction work is increasingly being done by contract foreign workers whose working conditions and benefits are usually inferior to those of direct hire workers.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 1997

(Millions of U.S. Dollars)

Category		Amount
Petroleum		1,367
Total Manufacturing		3,222
Food & Kindred Products	6	
Chemicals & Allied Products	197	
Primary & Fabricated Metals	23	
Industrial Machinery and Equipment	-136	
Electric & Electronic Equipment	2,784	
Transportation Equipment	0	
Other Manufacturing	348	
Wholesale Trade		235
Banking		(1)
Finance/Insurance/Real Estate		407
Services		90
Other Industries		(1)
TOTAL ALL INDUSTRIES		5,623

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.